

The Canadian Chartered Accountant

- Internal Auditing and Public Accounting
by H. W. Joyner
- The Best of Our Information
by H. L. Ross
- Historic Costs — The Lesser Evil
by Geo. Moller
- Programme of 47th Annual Meeting

JULY

1949



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The Canadian Chartered Accountant

VOLUME 55

JULY 1949

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MELVILLE PIERCE, *Managing Editor*

JEAN VALE, *Assistant Editor*

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The Canadian Chartered Accountant

VOLUME 55

JULY 1949

NUMBER 1

Summer

DURING the period when profound comment would ordinarily be expected from the editorial pen for this month's issue, the temperature in Toronto has remained almost consistently in the high eighties (this is high for a non-golfer). Further, the Canadian International Trade Fair has had a somewhat upsetting influence on your editorial writer's prosaic existence, to say nothing of a round trip to Regina in a space of 82 hours, which included two long days of meetings. The result is that here we are at a deadline date with nothing in our mind but the hope of holidays soon to come for all of us. We take some consolation in the fact that this issue will reach the desks of most of our readers while they are on vacation themselves or busy clearing their desks in order to get away.

May you all have the type of recreation which you most enjoy, fair weather, fine scenery, long evenings, good books and restful experiences.

Notice of Annual Meeting

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

Toronto, Ontario, September 10 to 16

The forty-seventh annual meeting of The Dominion Association of Chartered Accountants will be held in Toronto, Ontario, at the Royal York Hotel, on Saturday to Friday, 10th to 16th September, 1949, for the reception of reports and other business.

Further details are set out in the draft programme following.

Notice of motion has been received by the Secretary of a proposed amendment to By-law No. 1 of the Association to recognize the Institute of Chartered Accountants of Newfoundland as a corporation the members of which shall *ipso facto* be members of the Association.

E. J. HOWSON,
President.
Toronto, Ontario

CLEM L. KING,
Secretary.
4th July, 1949

47th ANNUAL MEETING**Draft Programme****Council and Committee Meetings****Saturday, 10th September**

9:30 a.m. Executive Committee

Monday, 12th September

9:30 a.m. Committee on Education and Examinations

2:30 p.m. Council

Tuesday, 13th September

9:30 a.m. Council

2:30 p.m. Council

Friday, 16th September

2:00 p.m. Council

2:30 p.m. Executive Committee

General Sessions**Tuesday, 13th September**

9:00 a.m. Registration

Evening Reception

Wednesday, 14th September

9:00 a.m. Registration

9:30 a.m. *General Session*—Symposium: The Use and Presentation of Published Financial Statements

12:30 p.m. Luncheon for Members as guests of the Institute of Chartered Accountants of Ontario

2:30 p.m. *General Session*—Current Accounting and Professional Problems2:30 p.m. *General Session*—Industrial Accounting**Thursday, 15th September**

9:00 a.m. Registration

9:30 a.m. *General Session*—The Taxation of Business Income in Canada, Great Britain and the United States2:30 p.m. *General Session*—The Income Tax Act

Evening Theatre Night

Friday, 16th September

9:00 a.m. Registration

9:30 a.m. Annual General Meeting

Evening Dinner and Dance

Special Programme for the Ladies

The Entertainment Committee are arranging a programme of entertainment for visiting ladies, details of which will be announced later.

The Hundred Ducats

By A. H. Howson, B.A., C.A.

A fable with apologies to Aesop

IN A FAR LAND lived an industrious man who, having attained great age, thought equitably to bestow his accumulated wealth upon his sons. Therefore, selling all his possessions, except those necessary for his simple needs, he received in exchange money.

Now his sons were four in all, and between them did he divide the money, admonishing them to husband their resources that they might prosper and do him credit. And each son received an hundred ducats.

The first son, requiring not this wealth immediately, took his hundred ducats and, by night, buried them in a secret place.

The second son, learning of his brother's action, bethought himself that such was indeed foolish since it was well known that the ruler of the land, being constantly in need of money, would be glad to borrow the money, giving in return a promise to repay together with a small compensation for the use thereof. And thus the second son arranged for the investing of his hundred ducats.

The third and fourth sons, consulting together, determined that opportunities existed for the employment of their additional capital to better advantage. Accordingly, purchasing each one a loom and hiring servants to operate them, they set about to produce a fine linen much in demand.

But a time of unrest descended upon the land and there were wars and famine even to a period of ten years. And a measure of wheat which once had brought but one ducat now commanded two. And the wages of a servant doubled. Likewise did the third and fourth brothers find that the products of their looms, being much sought after, could be sold at almost any price.

The third and fourth sons, therefore, watched their businesses prosper in this sellers' market. And the third son, thinking to enjoy the fruits of his enterprise, said, "I shall use for riotous living all of the swollen profits which I have gouged from my helpless brethren save only that sufficient to maintain my original capital intact. Therefore shall I set aside ten ducats a year so that at the end of ten years, when my loom is worn out, I shall again have my hundred ducats." And this he did, living riotously on the profits of his business as determined for him by his stewards.

At last the first son, finding himself in straitened circumstances, reluctantly determined to dig up his hundred ducats, thinking that with these he could live comfortably for many seasons. But great was his dismay when he discovered that he could buy only fifty measures of wheat with an amount which would have previously provided an hundred measures.

And likewise the second son, obtaining repayment of the money from the ruler of the land, together with the compensation for the use thereof, found himself in much the same position as his brother. For although he had received a certain sum additional, his hundred ducats bought only half as much wheat. "Can it be," he asked himself, "that wheat is worth twice as much now? Verily it will feed a man or beast only as it did ten years ago. Or can it be that it is the ducat which is worth only half as much?"

And also at the end of ten years, his loom being worn out, the third son, thinking to continue in his business, took his hundred ducats and set out to buy a new loom. But nowhere could a loom be purchased except for two hundred ducats. Much distressed, said he, "I shall borrow from my brother, who has already replaced his loom, an hundred ducats wherewith to re-establish myself in business." But his brother replying said, "Go, thou improvident one. Could a prudent man lend with confidence to one so foolish as to dissipate his capital as thou hast done?"

And great was the consternation of the third brother.

Seeking therefore to learn the secret of his brother's ability to buy a new loom, he asked, "But how is it that thou who hast been making and selling linen even as I, and under the same conditions, hadst the two hundred ducats for thy new loom?" And his brother replying said, "O man of dull perception! Couldst thou not see that the allowance made by thy stewards for the return of thy original capital was in fact insufficient? And because of that, the profits upon which thou hast lived so riotously, even after bearing thy burden of taxes, were largely illusory? Surely thy real capital was thy loom, not thy ducats. Therefore, it was for the replacement of thy loom at whatever cost thou shouldst have been providing."

Then did the third brother return to his stewards and berate them for their shortcomings, who argued that the master still had his hundred ducats. But nowhere would the hundred ducats purchase a new loom.

"Stitch In Time"

At Seattle, adjusters at work surveying earthquake damage told an unusual "stitch in time" story.

At 9 a.m. on the day of the quake, Hy Wolfstone, an agent for General Insurance Co. of America, submitted policies for earthquake insurance totalling more than \$2,000,000. The policies covered seven Seattle buildings. Kelly Waller, manager of the Company's Seattle district, and Charles Powers, the firm's earthquake expert, announced:—Policies approved and accepted. That was 10 a.m. One hour and 55 minutes later Seattle was rocked by the quake. Moments later managers of five of the seven newly insured structures telephoned for adjusters to come out and assess the damage.

—*The Chronicle, May 6, 1949.*

The Best of Our Information

By H. I. Ross, O.B.E., C.A.

(*Partner, P. S. Ross & Sons, Montreal*)

The development of accounting techniques under the stimuli of high taxation and widespread investment

YOU will all have heard of the bird that flies backwards because it is not interested in where it is going, it just wants to see where it has been. Its point of view is apparently considered odd in some quarters, but not by accountants — that's the way they work themselves. The statements which accountants produce for you do not forecast the future; they show what has happened to you in the past. They are thus primarily historical statements, although some consideration is given to presenting the results of past operations in such a way as to be useful to management and investors, who are interested principally in prospects for the future.

The work of the accountant might be compared (by the irreverent) with that of a handicapper at a race track. The handicapper concentrates on the past performance of the horses that are going to run, but he is concerned not only with the times they have recorded in former races; he also takes into consideration the conditions of the track and who the manager (or "jockey" as I understand he is called) was in each case. The analogy may be

pressed one step further — while we may expect an intelligent estimate to emerge from the material at the handicapper's disposal, it is a terrible mistake to count on infallibility.

Development of Modern Forms

Double entry bookkeeping was invented many centuries ago in a most improbable manner — if I remember correctly, by a Siberian monk. Every now and then someone digs up a brick with scratches on it that proves to be a Babylonian washing bill or something of the sort. This is a type of financial statement but it bears no resemblance whatever to the modern product of your accounting departments — except in being completely incomprehensible to most people.

Financial statements may be in all sorts of forms. In fact they may sometimes hardly have a form at all — like the statement telegraphed to the owner of a business who was on holiday but had fretfully written in to ask how things were going. That telegraphed statement read simply:

SALES DOWN TWENTY PERCENT
BUT DON'T WORRY EXPENSES IN.

An address to the annual conference for 1949 of the Canadian Bottlers of Carbonated Beverages, Montreal, March 1949.

VENTORIES RECEIVABLES OVER-DRAFT AND EVERYTHING ELSE AWAY UP.

While this lacks the precision of form and balancing features that are so dear to the accountant's heart, it would be hard to deny that it is an informative statement.

The Modern Balance Sheet

However, I would like to consider today financial statements of a slightly more conventional pattern; the balance sheet and operating statement which most companies produce annually in the more or less standard form are familiar to all of you. Financial statements bearing some resemblance to these conventional statements may be said to have first appeared with the invention of limitation of liability — over a hundred years ago. The laws limiting the shareholders' liability were a great stimulus to investment and thus to industrial development. The shareholder's personal property was protected and he risked only that part of his capital which he invested in the company. Now you might say that the maintenance of a proper balance between the claims of creditors on the one hand and shareholders on the other is one of the principal functions of company legislation. Thus when limitation of liability afforded the shareholders a measure of protection from the claims of the creditor, it was necessary to consider also the safeguarding of the creditor. Consequently by legislation, by court decisions and by developing commercial practice, something which looked rather like the modern balance sheet began to emerge. Until that time credit was largely a personal matter and there was no significant distinction between the credit of a company and the personal credit of the owners. When the company was made to stand on its

own feet or, as you might say, on its own assets, then naturally it was essential to devise some sort of financial statement that would show what those assets were and what other claims there were against them — hence the balance sheet which was, in the first instance, a credit document.

For the next hundred years development was relatively slow. Government supervision of public utilities was a stimulus to improvement and various other trends helped too. But it was, comparatively speaking, only yesterday that efforts to improve financial reporting became thorough-going, widespread and systematic. There were two main reasons for this increase in tempo. In the first place, there was the introduction of corporation income tax, a factor of immense significance. This tax was based on the profits shown in the financial statements and it thus became expensive (and increasingly so as the rates of tax rose) to make miscalculations. For example, the tax encouraged business men to listen to accountants who had for many years been urging systematic provision for depreciation. A direct financial incentive was added to the sensible arguments previously advanced. It cost money to ignore what had been considered in some quarters a rather academic device.

Public Interest Aroused

The second important reason for the acceleration in improvement of financial statements came from the vast increase in the number of investors which occurred notably with the stock market boom of the 1920's. The subsequent crash and the depression years focused everyone's attention on some of the inadequacies of financial statements. Stock exchange officials, government bureaus, accounting associations and the public at large were thus dramatic-

ally awakened to the importance of adequate financial accounting.

In many ways the balance sheet of today looks like the balance sheet of thirty years ago; but the resemblance is quite superficial. A great deal of thought has gone into refining and standardizing definitions and into developing logical rules of valuation. Moreover, the profit and loss or income account has received a great deal of attention. Thirty years ago it was little more than a technical explanation of how and why the surplus had changed between balance sheet dates. It is now a much improved statement and is, indeed, becoming far more important than the balance sheet itself. In the rapidly moving days in which we attempt to do business it is now realized that a company which loses money is a poor credit risk, regardless of how solid its balance sheet may appear at any given moment. Thus even for credit purposes the balance sheet has perhaps become a statement of second rate importance.

Many people would trace the development of modern statements in a somewhat different way but I have mentioned the three factors which appear to me to be of most significance — (a) the introduction of the limited liability company, (b) the levying of corporation income taxes and (c) the tremendous increase in the investing public. It is interesting to notice that two of these three developments occurred within the business experience of most of us in this room. Fundamental changes of this sort, when one lives in the midst of them, often tend to go unrecognized and it is for this reason that I have called attention to them at some length.

Valuation of Assets

A glance at the accounting journals will show, I think, some of the funda-

After graduating from McGill and Oxford, Mr. H. I. Ross, O.B.E., C.A., joined the staff of P. S. Ross & Sons in 1932, and was admitted to the Quebec Institute in 1937. Since 1940 he has been a partner in this firm. During the war he spent three years with the Foreign Exchange Control Board and for three years was Ration Administrator under the Wartime Prices and Trades Board. For his service in this latter office he was awarded the Order of the British Empire.

mental questions which are still being thrashed out. Perhaps most importantly, there is the question of asset valuation. Fixed assets (land, buildings, machinery and equipment) have traditionally been valued at cost. The best thing you can say for the cost basis is that any alternative method so far thought of has even worse shortcomings. One apparent solution would be to adjust the values of fixed assets each time to what they are worth at the balance sheet date; but this inevitably involves appraisal — a process which is not only costly but which bristles with practical difficulties. Most of you will be familiar with the problems involved and will understand why both business men and accountants have strung along with cost. It is at least a reliable indication of value at the time the assets were acquired because at that time someone was sufficiently convinced that these values were fair to pay cash for them. That is as close to an acid test as you can expect to get.

The present inflationary period has emphasized one of the principal weaknesses of the cost basis. To oversimplify a somewhat technical question, we might say that the depreciation pro-

cedure is supposed to provide automatically for the retention in the business of enough earnings to permit the replacement of fixed assets when they wear out. The profits shown by financial statements today are in general "over stated" in the sense that when the company's fixed assets finally wear out, sufficient money will not have been retained in the business to replace them, unless certain other measures are adopted to help do the job that the provision for depreciation only does in part during inflationary times. But to move away from cost values is no simple matter. I think this intricate and difficult discussion is summed up well in the following quotation from *The Economist* of a few months back—

Accountancy has not yet reached the stage at which responsible professional accountants will trust their reputations on . . . guesses instead of . . . known figures of actual expenditure.

A Prevalent Misconception

Without becoming too far involved in this question, I think it might be worth pointing out that it highlights one of the most prevalent misconceptions about financial accounting. We see in the press (and, I am afraid, in accounting journals too) references to the fact that accounting conventions "over state" or "under state" profits — or that the profits in financial statements are greater or less than "real" profits. But this is confused thinking. The concepts of assets, liabilities and profits have been developed for a purpose. They are supposed to be useful ideas but there is no question of trying to find "real" profits. There is only the question of what is the correct way of determining profits for a given purpose. Let me illustrate. There have been many long arguments on such questions as whether interest is an expense. These discussions are quite beside the point. Interest is a certain type

of expense which should be considered in calculating profits for some purposes and ignored for others. Similarly profits determined (as they are in today's conventional statements) by taking depreciation on the basis of original cost are neither more nor less "real" than profits calculated by taking depreciation on current replacement values. Each of these profits is significant for certain purposes. To say that one is not "real" because it is more or less than the other is to use words pretty roughly.

An important consideration results from this line of thought. As you know, there are several different groups who want to see financial statements; there are bankers, bondholders, suppliers, shareholders, managers, tax authorities and prospective investors. Each of these groups has a slightly different point of view and hence slightly different requirements. Ideally perhaps each group should have a set of statements designed specifically to provide financial information in the manner best suited to its purposes. To some extent this practice does indeed exist. It is quite common for a set of statements to be prepared for the shareholders and another in greater detail (and perhaps in slightly different form) for the guidance of management. However, to carry this policy to an extreme by issuing a special statement for each purpose would be most confusing. Instead, the custom has developed of publishing a set of "general purpose" statements. These are ostensibly prepared for presentation to the shareholders as a report by management on its stewardship. They serve, sometimes with minor amendments, for tax purposes and also for prospectuses and other requirements. The point to remember is that the ordinary published statements, with which you are familiar, are general purpose statements. It is often possible to recast them in a better form for a specific purpose.

The Accounting System

Most people starting up a business tend either (a) to design a set of accounts out of their own heads, thus getting loaded with the burden of their personal whims and idiosyncrasies, or (b) to get an outside accountant to set up a system for them, thus inheriting the outside accountant's personal whims and idiosyncrasies. It would be interesting to know whether you are getting genuine value out of your present accounting systems. If not, the remedy is to some extent in your own hands. A system of accounts is essentially a device to summarize financial items so that all the complicated and enumerable transactions of a modern business can be boiled down to a digestible number of significant figures. You should try looking at your most recent financial statement and asking yourself whether each of the figures in it is significant. If not, you should do something about it. Reading a financial statement is largely a non-technical matter, although producing a statement involves all sorts of technical problems. One difficulty with financial statements is that they tend to be prepared by one class of people (the accountants) and to be read or used by a different class (the managers and owners). Sometimes these two groups fail to understand each other's requirements and problems. It is the task of the accountant to produce the sort of figures the management needs and it follows that it is the task of management to decide exactly what is wanted.

Let me give the simplest possible kind of illustration. You will find many financial statements in which the expenses of, say, "telegrams, telephones and postage" are lumped together in one figure. This is probably a good general grouping but there is nothing sacred about it. Left to himself, it is a sort of grouping an accountant will make but there are

two obvious possibilities. First, the total of these three items may be so unimportant that to show them as an item merely clutters up your statement without serving a useful purpose. In such cases they might better be added in, say, to general expenses. Secondly, it may be that these items are important and in such cases, it may be advisable to show each of them separately. This same principle runs throughout your entire financial statements and if you are getting statements either too detailed or not detailed enough, it may well be your own fault.

All this is treating the subject in a somewhat cavalier manner and many other things have of course to be considered in practice. For example, the Act under which an association or company is incorporated may stipulate certain details that must be shown in the statements, regardless of whether they are useful to it or not. Moreover, frequently it costs money to provide extra information. The value of a certain breakdown of expenses must be weighed against any additional costs that might be involved in obtaining it.

Use of Financial Statements

Most of you who are managers or owners have a particular interest in financial statements. You need them to help you in making decisions on the current problems that keep pouring over your desks and in forming long range plans of operation. In the good old days, life was comparatively simple and it was possible to run a fair-sized business on a series of sound business maxims ("waste not, want not", "the customer is always right" etc.) without much attention to actual figures. Those were the horse and buggy days of business and they have certainly gone forever. It is hard now to imagine what the business man could have worried about back in the early days of this cen-

tury — practically speaking, no income tax, no supply quotas, no exchange problems, no unions, no government statistical returns. It is easy to see how much things have changed since those days. You can find at every turn dramatic examples of how complicated business is today. Just look at one of your payrolls and see the elaborate procedure of deductions for different purposes that has now become commonplace.

Taxes and restrictions are inherently unpopular and there are many who would advocate certain simplifications: the abolition of some restrictions, the reduction of some taxes. There are not many, however, who would predict a return to the free and easy days of the early 1900's. Whether we like it or not,

we are born to make our living in an economy which has become extremely complicated. The technique of accounting has developed along with other processes in order to make the carrying on of business possible under these perplexing conditions. It should be a tool to assist the business man in his difficult task, and a very important tool. The accounting department is part of the overhead and like other overhead elements, it contributes, in a sense, indirectly rather than directly to the success of business. It may sometimes be hard to be patient with his shortcomings, but whether you welcome it or not, the accountant is one of the essential members of the team that you, as managers, must direct.

Plain Facts Wanted

A year or so ago, The Chronicle made some comment on the new fashion of publishing corporation annual reports in elaborate form. A batch of the 1948 issues have in the past few months come under inspection. Some of them are really beautiful specimens of the designer's and printer's arts — almost exhibition pieces. Others are elaborate without being too pleasing in their general effect. At present levels of prices for high grade materials and skilled workmanship, the cost of these modernized annual reports must be very substantial.

Are they really worthwhile? The wastage of copies among the rank and file of shareholders, men and women alike, who give their copies no more than casual attention before pitching them into the waste paper basket, must be considerable. The business and financial community, and those who are in charge of investment portfolios, are interested more in the information these reports contain than in their format, and possibly would be better pleased with a concise statement than with having to hunt for what they want through pages of graphs and colour printing.

These reports do in the main tell the story of business in more detail than in the past, but it seems possible that this desirable and, indeed in these days, essential step has become involved in the theory that the story can only be told through the methods of magazine advertising. Nobody in these days questions the power of attractive presentation, but there is a question in connection with these reports whether the particular and costly presentations which have been developed in some instances are the best for the particular audience of readers they are designed to reach.

Some of our largest and most successful corporations still stick to the "penury plain" type of report, in format, but give their readers in plain language a clear story of the company's year. The more elaborate form appears to be on the increase for the time being. Whether the movement will persist through a period of declining profits, when management is scanning closely expenditures, remains to be seen. The really vital point is that business continue to tell its shareholders, and through them in these annual reports, the public, its story plainly and clearly.

Respite from the Audit Business

By W. E. Smith, C.A.

From the Saguenay to the Mexican Gulf and back

THROUGH a client in the shipping business, I was enabled to take advantage of a trip on a Swedish built, Norwegian owned new 3,000 ton oil-burning freighter, the "M/V Three Rivers", from Port Alfred to the Gulf of Mexico and back. By courtesy of the captain, I was given the run of the ship including the bridge and chartroom. A few impressions may be of interest to readers.

The arrival at the dock at Port Alfred was a revelation. Bauxite, a dirty brown ore, was being unloaded from ships for the aluminium plant at Arvida, Quebec, with new docks being rushed to completion to service the increasing flow of traffic that is piling up during the navigation season. The port captain, a genial "skipper" from the Manchester Line who has moved ashore, arranged the formalities, and I went aboard the ship, which was loading newsprint for Miami, Florida. Intermittent rain delayed loading operations and, as a consequence, it was past midnight when we cast off, and a view of the Saguenay River was postponed until the return trip.

On mounting the bridge next morning we were nearing Father Point, with the pilot still aboard, and nothing eventful happened till we went through the Gut of Canso in the evening, which was made possible by the absence of fog. This narrow winding passage calls for careful navigation and constant minor changes in the course, but the sun was shining and the view of the shores of Nova Scotia and Cape

Breton was quite impressive. After that, fog and still more fog, twenty-three hours of it. The captain was on the bridge or at call most of the time, and I spent a period with him peering into the pea-soup atmosphere and listening to the continual blast of the fog-horn.

At last we arose one morning to blue skies and blue water in the Sargasso Sea, which was our first promise of the heat to come. The passage down was made fairly well out to avoid meeting the Gulf Stream, and the ship finally moved in through the Bahama Banks to Miami to unload. The view from a ship approaching Miami is of a flat plain, lined with skyscrapers which are the modern hotels that spread along the shore. For further information about Miami, read the tourist pamphlets, sufficient to say that I toured the city, and had a swim in the warm water.

Complying with United States shipping laws, the ship left Miami without cargo while moving to another United States port. We sailed down the Florida coast and into the Gulf of Mexico. The chief impressions were a luxury liner crossing our bows, sticky heat, liberty ships going in "light" for cargoes and the ubiquitous Norwegian tankers. Our arrival at Galveston, Texas, was marked by blue skies and bright sunshine, but if anyone imagines Texas as a land of rolling hills and beautiful ranches, he may be assured that this part of it is flat, dreary, unin-

teresting land, but with a wealth of oil and minerals beyond belief.

We loaded sulphur, a clean but troublesome cargo, as escaping lumps from the "hoppers" will start fires on any wooden part of the ship that they strike, and hoses are kept going continuously. The effect on brass fittings and paint work is damaging, and immediately after sailing, all hands, including the captain and the C.A., were called to clean up and get things "ship-shape". The exercise of the hand in the checking of postings must be good training, for the C.A. was complimented for his paint work on the bridge.

Our direct return passage was made without any event of importance. The Gulf Stream was running fairly fast, and with this aid and good weather we made about 17 knots, sailing close inshore, with a view of the coast resorts

through the binoculars. One small waterspout at sea and a literal cloudburst of rain ashore were the only events until we came up the coast of Nova Scotia, where we met a cold north wind and "dour" seas. An upbringing in this climate may explain the characteristics of the average "blue-nose". The sail up the Saguenay river was superb.

We finally arrived back, and anchored in the bay to join a dozen other ships awaiting berths. The sky was overcast and the day dull and cold, a fitting return to the accountancy business.

My impressions! A renewed respect for the men that go down to the sea in ships, and for the Norwegian race in particular, and a continued regard for the unchanging sea, alternately ruthless and kindly, but clean, and close to the things that are eternal.

International Congress on Accounting, 1951

THE following paragraphs are quoted from the address of Sir Frederick Alban, C.B.E., J.P., president of The Society of Incorporated Accountants, to the Society's annual general meeting held on May 25, 1949.

INTERNATIONAL CONGRESS ON ACCOUNTING, 1951

Prior to the war, it had become an established custom for an International Congress on Accounting to be held about once in every five years. An informal exchange of views between a number of accountancy bodies has indicated the desirability of again giving expression to the international aspects of accountancy, in such ways as may be practicable. Already there has been a considerable exchange of information and of current literature, and, during my Presidency, I have had the privilege of correspondence

with members of the profession in all parts of the world.

Accordingly it was decided that an International Congress on Accounting should be held in the not distant future. With the cordial concurrence of our friends in Canada and the United States, the profession in Great Britain and Ireland has offered hospitality and will make the necessary arrangements for an International Congress to be held in Great Britain in 1951.

A Congress Committee has been constituted to undertake the organisation of the Congress. The Chairman of the Committee is Mr. B. H. Binder, the President of the Institute of Chartered Accountants, and I have the honour of being the Vice-Chairman. We look forward to the Congress with much interest, and I rely on the support of Incorporated Accountants in according a warm welcome to the guests of the Congress from overseas.

Internal Auditing and Public Accounting

By Harold W. Joyner, C.G.A., F.C.I.S.

(Comptroller, Standard Brands Limited)

The increasing importance of the auditor inside the business — with its concomitant effect on the place of the outside auditor

A VERY great deal has been written in the past three or four years about internal auditing. Much publicity has been given to its responsibilities and aims. Much has been made of its potential value to management. Here are a few phrases I ran across in my research on this subject recently:—"Independent Appraisal Activity" "Tool of Management" "Top Management" "Top Staff Agency" "Administrative Control". Have you noticed how easy it is to get glib about this sort of thing? How the sonorous phrases roll — not trippingly — but ponderously off the tongue?

I think perhaps external auditors ought to look to their laurels or they may find that this child — and after all it has public accountants to thank for its birth in the beginning — may well become more important to top management (see how easy it is to throw these large, weighty phrases around) than themselves. Indeed, in a number of instances the internal audit department, by extension of its activities, already performs a much more useful service to management than do public accountants. The internal audit department concentrates upon the problems of a particular organization and, through its persistent activity, provokes better and more efficient handling and

stimulates effective thinking in many directions.

At the same time public accountants are confining themselves more and more to balance sheet audits, which are forced upon them by the demands of law through the *Companies Act* and the taxing statutes, and are becoming more and more quasi-judicial in character all the time. Then, too, there has been a tremendous increase in the number of clients to handle so that no one client can possibly get the detailed attention it feels itself ever more in need of — unless it creates an audit department of its own.

Of course I don't need to say that the more complex and widespread the activities of an organization the greater the need for an internal audit function — such a situation is self-evident.

Internal Auditing

I wonder why we don't call it accounting service and its head an accounting service manager or something similar, instead of an internal auditor? Most of you may have heard of Elbert Hubbard's definition of an auditor —

The typical auditor is a man past middle age, spare, wrinkled, intelligent, cold,

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passive, non-committal, with eyes like a codfish, polite in contact, but at the same time unresponsive, calm and damably composed as a concrete post or a plaster of Paris cast; a human petrification with a heart of feldspar and without charm of the friendly germ, without passion and without a sense of humour. Happily, they never reproduce and finally all of them go to Hell.

Shades of Charles Dickens! Don't you all want to be like Scrooge and turn back from this evil path before it's too late? With such a description — and that's just about how most people regard auditors — how on earth can the internal auditor make friends as all the authorities say he must? Why, it's beyond human nature. As well expect somebody to make friends with Dracula or Frankenstein. My first point in brief is that I don't like the term "internal auditing".

Can we now get down to an ordinary definition of this service activity? After all internal auditing is just a service department in business affairs, albeit one which has — as I am well persuaded — a vast reservoir of potential service as yet practically untapped by management. Internal auditing differs in some respects in almost every organization and differs very widely too, but the most usual concept of the function is that it is the *eyes* and *ears* — but not the *voice* — of management, searching in every activity of the business for assurance:

1. That company policies and practices are being adhered to.
2. That no fraud is being perpetrated against the company.
3. That adequate internal control exists — by internal control we mean the check of the work of others by one or more individuals — as part of their regular routine of handling documents.
4. That advantage is taken of every opportunity for cost reduction or other savings.

In short — internal auditing is a meth-

od of checking on the *efficiency* performance of all departments.

Turning to external auditing, I think we shall have no difficulty in agreeing that the modern concept has emphasized the shareholders and legal aspect of the function to the point where external auditing is no longer — if it ever was — a tool of management at all. I do not mean to overlook the services rendered by external auditors to financial and accounting management in the field of taxation, etc., nor the benefit they can and do give to commercial enterprises by their knowledge of current practices in other organizations. However, it is a fact that most companies have their own peculiar problems with which to cope and their own ways of handling daily affairs and it is in this field that there exists the greatest opportunity for really effective and continuous benefits from detailed scrutiny of operations. In this field, the internal auditor has an unrivalled opportunity to assist management.

Audit Programmes

I don't find that there are many differences between the audit programme followed by external and internal auditors except as to the frequency of audit and the scope of the examination, but there certainly are differences in the outlook of the internal versus the external once the audit feature proper has been handled. By and large it may be said that the interest of the external auditor is at an end once he has completed the task of satisfying himself that the figures he has to certify truly represent results and values as stated, and that reasonably effective internal control exists. However, the internal auditor must shape his examination toward much more extensive ends. He's really vitally interested in the procedures and methods being followed — in uniformity of handling — in the best and most economical ways of

doing things — and in little time-savers and short-cuts. In short, he's most interested in the *efficiency* standard.

But let us progress a little into specific details: Let us presume that we have a rather large organization which maintains an internal audit department employed on continuous audits and that the firm's public accountants are to do a balance sheet audit only. The external auditor for the enterprise quite definitely should be interested in the following aspects of the internal audit department:

1. The detailed instructions given to individual auditors showing the field they are to cover as a minimum. This the external auditor is interested in for the purpose of ascertaining just how much reliance he can place on this coverage.

2. He will also sit in with the supervising authority in setting up the programme of audits for the succeeding year and arrangements will perhaps be made by him to take part in one or more of these audits at important points. Thus he can satisfy himself by observation that at least all of the most important units will be examined in the course of the year and further that the work called for is duly and properly handled.

3. He will also wish to receive copies of audit reports or at least will want to have the right to examine such reports at intervals so that he may have current knowledge of conditions in the organization.

4. And finally he will be interested in the calibre of men who are to handle the work. This again in order to satisfy himself as to the degree of reliance he can place upon the work of the internal audit department.

Normally the external auditor in such cases will not make any other than an annual examination (except for any joint internal audits in which he chooses to engage).

Specialization

As you know, the vast differences in

organization of various enterprises and, particularly, between types of industries, create peculiar problems in *external* auditing — so much so that seniors have to specialize in certain fields in order to be able to do an adequate job for their clients. How much greater then must the differences be when it comes to *internal* auditing, which deals with the very innermost workings of the unit? Obviously — since I am not Socrates, but only an accountant who has spent virtually the whole of his working life in two industries — electrical manufacturing and food — I cannot hope to cover all the different industries. One would need to gather the experiences of many to handle such a task but, nevertheless, there are certain routines applicable to virtually all industries and if we take Standard Brands in Canada as a fairly representative national organization, we should have a pretty good idea of an average internal audit examination.

Before giving this outline, though, I thought you would be interested in a brief sketch of our organization. Standard Brands Limited was formed in 1929 and subsequently acquired the businesses carried on by the Fleischmann Company of Canada Ltd. (yeast and malt products), Chase and Sanborn Ltd. (coffee) and the E. W. Gillett Company Ltd. (baking powder). In 1946, the Company also acquired the Ingersoll Cheese Co. Ltd. and today its principal products are Fleischmann's yeast, Chase and Sanborn coffee, Tender Leaf tea, Magic Baking powder, Gillett's lye and Ingersoll cheese — all exceptionally well-known in Canadian households. It is a wholly-owned subsidiary of Standard Brands Inc. of New York. It has a complete slate of corporate officers with a president, two vice presidents, a secretary and treasurer and a comptroller. Our executive office is in Montreal and we have major executives heading the three major departments

of the business — manufacturing, sales and finance, and accounting. We have four manufacturing plants and six main sales districts in Canada with more than 30 branches working within the sales districts.

The major items we manufacture and sell are divided into two groups, one of which we call Fleischmann — selling to consuming outlets such as bakeries, hotels, and restaurants — and the other grocery — selling to chain stores and other outlets, the latter through jobbers and wholesalers. The Fleischmann business, being perishable foods which have to be serviced every few days, is handled through a personal delivery system, while the network of branches across the country is also maintained to service this business. The grocery business is largely handled on a direct shipment basis — directly from manufacturing plants — although we do maintain some branch stocks across the country, particularly in the Maritimes and the West.

Accounting

As comptroller, I am, of course, responsible for accounting policies and practices in Canada and we have our best key men in Montreal to assist in the application of these policies and practices. Our field offices, however, are completely autonomous. District and plant accountants report to field managers, not to me, but we have representatives travelling around to lend guidance and assistance to the field offices and, so far, have been able to work with the greatest harmony all round.

All plants are completely self-contained accounting-wise. They have their own general ledger, property accounts, payrolls, etc. They make all their own disbursements, operating from bank accounts maintained by periodical transfers from concentration accounts. At three of our four plants we operate a standard cost system.

Sales districts maintain dollar and unit sales and inventory records and accounts receivable ledgers, handle billings, collect accounts and deposit moneys. They pay all their own expenses (except payrolls) from accounts we replenish on an *imprest* basis. They do not have payrolls or property records nor do they handle costing of sales or distribution of advertising and transportation expenses — all of this we handle at the executive offices, the theory being that the district manager shall handle only those items for which he is held responsible and not even these if it is much cheaper — as it is in the case of payrolls — to centralize the handling for all units. At the executive offices we have the corporate books — all payrolls and property records except for plants — and we also handle sales costing operations, production of total company reports and kindred matters. We also have at the executive offices a staff unit responsible for procedures, statistics, budgets, forms control, and taxes.

Auditing

Responsibility for internal auditing is vested in the general auditor of the parent company in New York, but we ourselves supply assistance to his men in the larger units, while our field accountants handle the audit of all branches and small units. In the fall of each year the general auditor and myself, in consultation with our public accountants, determine the schedule of audits to be conducted during the succeeding year and establish dates and other details in connection therewith. Copies of all audit reports are furnished to me as comptroller and I am responsible for handling with the executive officer concerned. Copies of audit reports on sales district offices and plants (but not sales branches) are also furnished to our public accountants. All audits are conducted according to an audit programme while we have an audit

questionnaire form which is required to be completed and which forms a basic working paper for permanent file.

While I shall now outline a reasonably comprehensive plan of the internal audit coverage in our field offices, I cannot emphasize too strongly the importance we attach to the observations we expect our auditors to make as they proceed with their examinations and the assistance we expect them to render to field management. We do try most sincerely to foster among our field management a feeling that our auditors are not spies. They are not in our Company's employ for such a purpose but they are employed to stimulate effective thinking and to bring to field offices the benefit of their experience and knowledge of inter-related departments of the business in order that we may attain the highest possible operating efficiency. I mention this especially because a cold outline of the audit programme does not acquaint you with the all-important spirit in which such examinations have to be conducted in Standard Brands.

Cash

Cash funds are verified as to amount and authorization. Cash expenses are checked for type and approval. Frequency of deposit is checked. Undeposited receipts are examined and subsequently checked to duplicate deposit slips. Bank reconciliations are prepared as at audit date. Previous monthly reconciliations are examined as to preparation. Bank statements (or certificates) are secured directly from banks, also cancelled cheques. Signatures and endorsements are examined.

Accounts Receivable

Accounting office prepares aging schedules of open accounts (over \$10.00 if delinquent, over \$500.00 if current). Schedules are checked by auditor on a test basis. Adjustments (particularly ac-

counts written off) and credits are examined for authorization. Delinquent accounts and credit balances are examined as to handling of such cases. Confirmation statements are mailed to all listed customers and also to selected customers where accounts have been written off since previous audit. Cash receipts are test checked to deposit slips.

Dues From Officers and Employees, Also Claims Receivable

Authorization for loans to employees are carefully examined and repayment terms noted and checked. Expense advances are noted and checked to authorized list, also vouchers are checked as to accounting for advances. All receivables are checked as to age, collectibility, etc., also confirmed by correspondence if no current evidence of indebtedness is available. Claims files are examined for prompt handling, compromise settlements, etc.

Inventories

Plant audits are scheduled to begin on the first working day of a month so as to facilitate the checking of inventories which are taken by plant personnel as a normal operation every month.

Sales district audits are also scheduled to begin on the first day in order to facilitate all aspects of the work although this is not so important with respect to finished goods which are inventoried daily in district offices and weekly in branch offices.

The auditor makes test checks of physical inventory quantities for the purpose of satisfying himself as to the accuracy thereof. He also secures verification from outside warehouses and inspects office records thereof. Prices and extensions on all inventories are test checked by the auditor. Old and obsolete items and over-stocking are also checked. The auditor inspects all inventory adjustments that have been made since the past prev-

ious audit and examines authorized signatures in respect thereof. He also checks book figures applicable to current inventories, in transit items, unbilled shipments, etc.

Inventories include raw materials, goods in process, finished goods and supplies, including packing materials, expense and garage supplies, etc.

Fixed Assets, Leasehold Improvements, Reserve For Depreciation

A summary is prepared covering all changes since the previous audit period. All changes in items over \$500.00 are verified for handling in accordance with company's capital asset policy.

With respect to new construction or purchases, requests for appropriation of funds are examined, actual costs are checked against estimates, account classifications are checked and estimated savings are checked against those actually realized. Requests for authority to dispose of assets are checked for authorization and recoveries are checked for evidence of possible fraudulent disposals, etc. Enquiries are made as to idle equipment and lists prepared for discussion with management, etc. Provision for depreciation and amortization of leasehold improvements are checked for adherence to Company policy. Property cards are examined and checked against most recent physical inventory lists and numbering of equipment is checked on a test basis. All book adjustments are checked for authorization.

Prepaid Insurance and Taxes, Deferred Charges, Accrued Taxes and Sundry Suspense Items

These items are checked as to monthly charge-offs and accruals, tax assessments, etc. Such items as workmen's compensation returns and accruals and payroll with-holdings are also examined and tested as to proper handling. The make-up of insurable values reports is also

checked in this part of the work especially with regard to conformity to company policy on insurance. Suspense items are carefully examined for evidence of dilatory or careless handling, etc.

Sales and Returns and Allowances

Procedures followed in handling of sales and trade discounts and in granting credits for returns or price allowances are examined. Unusually high ratios of returns, instances of numerous allowances and credits are examined carefully and authorizations checked.

Orders and Billing Procedures

The auditor observes carefully the manner in which orders are processed looking always for inefficient methods and complicated handling tending to delay completion of passage of the order. Among the phases checked are credit approval routines and pricing, etc. Prices and discounts are checked to approved price books — latter are checked for prompt filing of changes. Billing routines are reviewed as to promptness in handling and to see that prices, extensions, etc., are being properly verified, and that approved procedures for internal handling are being followed, etc.

Branch settlements and billings are examined to ascertain that they are being properly checked at district offices and that quantity discounts allowed are being checked, etc. Checking procedure in use is reviewed in the light of present conditions, etc.

Gratis Goods and Exchanges

All *gratis* goods are reviewed and larger items discussed with sales managers. Approvals are checked. Ratio of exchanges of perishable goods are checked against pre-determined expected ratios. Individual salesmen and branch experiences are compared and out-of-line conditions investigated. Enquiry is made as to disposal of stale goods and the policy

and procedure in handling exchanged and returned goods is checked for conformity therewith, etc. Allowances to customers are checked for evidence of possible irregularities.

Sales Department Records

Review is made of the statistical records of sales by products and by customers, oil and gasoline reports, route records, etc., to determine whether these were being maintained satisfactorily.

Costs

Method of computing costs is examined. Handling and make-up of cost variances is examined and test-checked. Method of allocating transportation charges is examined and — under this heading — enquiry is made concerning routings used and methods of transportation chosen in order to uncover possible inefficient and wasteful operations.

Enquiry is made as to reasons for unusually high cost variances or items of operating expense out-of-line with previous experience, etc.

Miscellaneous Income

Nature of items is ascertained and sources examined particularly on disposals of scrap, write-off of unused supplies, materials, etc.

Disbursements

Our practice is to take one-half of the previous month's vouchers and check them thoroughly to voucher registers as to names and amounts and to actual cancelled cheques. We test-audit invoices to see that approvals are in order and as to verification of prices and extensions, transportation and discount handling, sales taxes, etc. Special payments such as donations, membership dues, etc., etc., are checked to authorized lists. Transportation vouchers are checked against bills of lading and rate schedules, etc. Payments to employees are checked for authorization. Account classifications

are checked. The procedure in handling invoices for payment and the internal control inherent in the procedure is carefully observed for inefficient or insecure methods, etc.

Payrolls

Detail check of all payrolls (weekly, semi-monthly) is made for one payroll period including comparison of cheques with payroll as to date, number, payee and amount; signatures and endorsements are examined.

Rates of pay are checked to approved employees' record cards; overtime worked by weekly rated employees is checked to properly approved weekly time record; overtime premium portion of overtime worked is checked as to segregation from overtime hours paid on regular scale, etc.

Extensions and footings — employee withholdings — approval of changes — method of distribution to expense accounts — all these are checked by the auditor in detail in respect of the payroll being examined. Cheques for one pay period are distributed to employees by the auditor personally.

The following question must be answered by the auditor:—

In your opinion, is there adequate check, control, and competent administration over *all* payroll procedures, including:

- (a) Approvals for rates of pay.
- (b) Calculating of deductions.
- (c) Preparation of payrolls.
- (d) Payment of salaries and wages.
- (e) Issuance of related reports such as those pertaining to unemployment insurance, withholding taxes and matters pertaining to group insurance and retirement pension plans, etc.

The auditor must also provide answers to the following questions:—

1. Are accounting department and other instructions kept filed up to date?

2. Are they being followed?
3. Are monthly closing schedules being followed?
4. Are the accounts receivable unit and credit department under control of different persons?
5. Have you determined that the person in charge of incoming cash does not have access to ledger cards?
6. Was inquiry made into methods of recording miscellaneous non-product sales?
7. Was the general appearance of the office satisfactory?
8. Were employees orderly during office hours?
9. Were all desks cleared at night?
10. Were records neatly kept?
11. Was the condition of files satisfactory?
12. Was work found to be up to date or in accordance with normal satisfactory cycle?
13. Are employee relationships satisfactory?
14. Are all accounting office employees eligible for vacations taking them as scheduled?
15. Do you have any particular comments concerning office arrangement of work or organization?

Audit Reports

Audit reports are reviewed in draft form with the local management before leaving the location. Any comments he may have — and we get comments on all major aspects — are secured and incorporated in the reports. On all major unit audits, my own comments are also incorporated in the report before it is issued, the draft being sent to me before final release for that purpose. At the same time we thus have an opportunity of making suggestions regarding the report in case of possible misstatements, etc. As already stated, we supply a copy of the report to our external auditors and all working papers are available for their use at any time.

We use a standard form of report only in that certain basic comments are re-

quired in respect of every examination. Otherwise the auditor comments according to the circumstances. All small matters and unimportant items are omitted from formal reports although noted in working papers.

The co-operation of our field men with the parent company's internal auditors has proven to be most valuable to both of us for we are in a position to take advantage of their experience and knowledge while they in turn are able to carry back with them ideas gleaned from Canadian operations.

Before closing, there are two matters I want to pass along for consideration and it may be that these will provoke discussion:

The first one is the fact that I feel that the best internal auditor does not come from public accounting ranks. In my opinion, what is needed is a man with some outside experience but — above all — with several years of accounting service in the organization before being made an internal auditor. The key to this thought is contained in some of the first words I used earlier in describing a company's need for attention to its own particular problems. As everyone knows, each company has its own way of handling paper work, usually a way suited to its own situation and to no other — therefore an internal auditor must really know the organization and its individual intricacies before he can do a worthwhile job for his management.

The second point is that I am impressed with the modern thought among students that they do not get enough practical accounting training in the formative years when they are serving the required time in public accounting firms. I wonder if it would not be possible to exchange an internal and an external auditor student for a certain time with benefit to the student in industry and to the one in public accounting.

Historic Costs — The Lesser Evil

By George Moller, D.Jur., C.A.

(Assistant Comptroller, Robertson-Irwin
Limited, Hamilton)

A critical review of depreciation charges on the replacement cost basis

IT CANNOT be mere coincidence that the editorial of *The Accountants' Journal*, the official organ of the New Zealand Society of Accountants, November 30th, 1948, is headed "Depreciation Accounting", that the editorial of the *International Accountants' Journal*, December 1948, starts with an article entitled "The Depreciation Gap", and that the leading article of *The Journal of Accountancy*, January 1949, "Effect of Inflation on Capital and Profits", centres around the hottest controversial subject of established accounting methods versus accounting in terms of purchasing power or fluctuating money value.

Replacement Cost vs. Historical Cost

One of the main issues is whether the accountant should condone or — to go to the extreme — advocate providing for enhanced replacement costs in the annual depreciation provisions or persist in the accounting principle that only actual original costs of assets may be charged to operations during the period of their useful life.

The main difficulty is finding an objective basis for ascertaining replacement costs. It is not necessary to elaborate this statement, as replacement costs are

continually changing and technically it would be almost impossible to undertake the ascertaining of them every year (which would amount to nation-wide annual appraisal of all enterprises with fixed assets). Quite apart from this difficulty, even the appraisal would not provide a reliable basis for the determination of depreciation provisions for the past year, because the appraisal could form only a basis for future charges and this basis would again become incorrect during and at the end of the next year, when applied to past periods. The conclusion is that you cannot beat the consequences of inflation by merely changing your accounting methods.

To comprehend relativity, one needs the genius of an Einstein and it is no exaggeration to state that the scientific achievements of this leading physicist and mathematician and his associates are still far from being the common property of all educated people.

That revolutionary thinkers in the field of accountancy try to discard the monetary unit as a measuring stick for economic life, without having a practicable and understandable substitute of permanent validity, is suggestive of a lame man

who throws away his crutches because he cannot walk with them as well as other people on their sound legs.

The postulate of stability in the monetary unit can be maintained on this continent.

Temptation

In times of decreasing purchasing power of the dollar — to stay within our own monetary sphere — there is a temptation to grope for something less fluctuating and more stable to express economic facts or events. This temptation should be resisted after having a look at indices of consumers' prices for the comparatively short period from the beginning of the century to the present day.

At one point in these 48 years the dollar was at almost the same low level of purchasing power as it is to-day:

1920	0.31
1948 to October	0.32
(taking 1900 as 1.00)	

Against these low points were the periods of high purchasing power, usually at the same time periods of economic depression:

1914	0.75
1933	0.73

If one takes into consideration that buildings are on the average depreciated over a period of 40-50 years, it becomes immediately evident that fluctuations of the monetary value, which have their peaks and lows within such depreciation period, cannot be all-important. One glance at a chart, prepared by the Toronto Builders' Exchange, shows that costs of construction, building materials and wage rates are sometimes not subject to the same fluctuations, but go their own way for considerable periods, which again does not conform to the course plotted by the Consumers' Prices Index.

Many experts may object that the field of depreciation is only a narrow sector

of the whole problem, but against such objection a valid argument may be presented that money fluctuations hit in the main the accounting for fixed and long-term assets. Current assets which are supposedly turned over within one fiscal year and therefore practically valued at current costs can safely be disregarded in these considerations. In the United States the LIFO method may help to overcome this difficulty. In Canada the Department of National Revenue has not yet seen fit to approve the use of LIFO. It is doubtful whether it would be sound policy to permit LIFO now when prices are at hitherto unexperienced height and the likelihood of falling prices is at least as great as the possibility of a continued rise.

Effects of Real Inflation

It is perhaps hard for people who have never experienced real inflation, usually ending with the collapse of a monetary system, to realize the comparative pettiness of their exaggerated tribulations. In countries which have undergone real inflation the question of depreciation rates was insignificant in comparison with the daily worry of how to satisfy the worker and employee in purchasing power out of proceeds of sales which, since their collection, had diminished considerably in their real value. At the end of an inflationary period there has always been either a completely new currency with an inevitable new appraisal of existing fixed assets and a new start in taxation, or at least writing-up of fixed assets by the use of keys (price indices) usually encouraged by the government concerned through the acknowledgment of such write-ups for taxation purposes as a basis of increased depreciation. Such measures were always taken at a time when the government saw that a new and comparatively stable price-level had been established and appraisals were by no means a recurrent feature. A classic ex-

ample is the German change to the gold-mark in 1924 (*Verordnung ueber Gold-Bilanzen* of December 28, 1923 and the corresponding regulations concerning taxation and accounting). Section 19 of this decree states definitely that the change in the valuation brought about through the change in the currency does not form the basis for any kind of taxation.

Depreciation in Canada

We accountants in Canada have acquiesced too long in artificial outside influences which are neither logical nor economically sound and which have forced us to accept and certify, as true and accurate, statements containing items of — to say the least — very debatable accuracy.

Foremost in my mind in this connection is the practice of depreciation in Canada.

I think it would be possible to define depreciation rates in Canada as follows: "Depreciation is what the tax department allows." We have only to remind ourselves that we have patiently co-operated in allowing the same machine to be depreciated 10% p.a., if purchased and installed before November 10, 1944 and 20% p.a., if acquired after that date, but before March 31, 1949, and qualifying for double depreciation.

I do not overlook that many arguments have been advanced for double depreciation, fiscal arguments as well as economic ones, but the fact remains that a jump of 100% in depreciation rates cannot be explained away and remains an arbitrary measure not representing economic facts. The extent of double depreciation should, at least, be carefully disclosed on every balance sheet and profit and loss account, a requirement which, we regret to say, has by no means yet become accepted accounting practice in Canada.

Shake Off Tax Regulation Shackles.

We should strive with all our strength to shake off the shackles of tax regulations from depreciation accounting. It would cost the Department nothing and restore, to a large extent, fair presentation of accounts, if the rule were relinquished that no depreciation must be claimed for tax purposes which has not been set up in the accounts. This would open the way for strictly economic considerations of the problem of depreciation in every enterprise without waiving any tax relief the fiscus feels fit to grant to the taxpaying public for reasons of its own. Even under the present system the Department and consequently the taxpayer have to keep in most cases detailed records of asset values and depreciation reserves for taxation purposes. Let us merely continue these records without reflecting tax depreciation rates in our accounts.

Double depreciation was allowed in order to facilitate rehabilitation and avoid a post-war slump by furthering capital expenditures. It has since been realized that this incentive was not necessary. Now certain people are clamouring for depreciation allowances in excess of historic costs of assets, claiming that corporations are distributing their capital as dividends to their shareholders by neglecting to make provision for depreciation on replacement cost basis. This is sheer propaganda. No board of directors can be forced to declare a dividend if the directors feel that it would amount to a distribution of capital. The only valid objection is that at present the fiscus taxes those profits which result (in part) from the fact that the taxpaying enterprise was and is working with cheap fixed assets. The proportionate part of the cost of sales, representing depreciation, is therefore smaller than it would be for an enterprise which purchased its machinery or other fixed

assets in a period of high prices (i.e. low purchasing power).

This is by no means a unique problem and should be reduced to its appropriate size. What do those enterprises with cheaply bought fixed assets really want? They want to retain part of their profits which they feel they will need for replacing their cheaply bought, outworn assets in times of high prices.

Two Fallacies

There are two fallacies in the problem:

1. At the time when they will actually replace the assets, which may be any time from 1 to 49 years from now, prices may have come down, perhaps to pre-war level and lower. In Canada they can retain their profits less 35% or 37% taxes. What they really want therefore is a relief from the 35%-37% taxes. Why not call a spade a spade and ask for such a relief? On the other hand, the enterprises which have recently bought fixed assets, will perhaps request some relief, because they may have to pass through times of recess or depression, when their earnings will not provide sufficient depreciation of these high costs. Their argument is at least as much justified as the other and has been partially resolved in the United States by accelerated depreciation of newly constructed plants in the early years of operation.

2. We live in a free enterprise system. Nobody is forced either to acquire fixed assets at high prices or to distribute profits which he deems not real. Economic considerations should take taxation into account and arrive at logical decisions. It is like shooting sparrows with a cannon to suggest upsetting the hard-won practice of depreciation based on historic costs in order to achieve a limited tax relief of some kind or another, or in order to avoid showing profit figures which may be an incentive for wage-

earners or employees to renew their demand for wage and salary increases.

Canadian study groups on tax problems have discussed in the past year the problem of depreciation based on replacement costs. They came to the conclusion that the suggested increase in the normal rate of depreciation on new assets in the early years of their operation would not be a permanent solution. The majority seem to have shared the opinion that the question of making provision for enhanced replacement costs should not be confused with the problem of charging to operations the capital cost of assets during the period of their useful life.

Opinions From Other Countries:

1. England

The whole discussion gained momentum from the comments of Sir Geoffrey Heyworth, presiding at the annual general meeting of Lever Brothers & Unilever Ltd. on August 26, 1948. His remarks were widely distributed and aroused a very lively interest especially in industrial circles. Reading Sir Geoffrey Heyworth's address carefully, it seems to me that there are at least two instances where his approach is restricted to conditions outside of this continent. He stated that government controls prevented the manufacturer from recouping the economic value of his cost of sales through the sales price of his product. Price fixing, apart from rent control, has practically been abandoned on this continent since 1945. A further deceptive conclusion seems to stem from his assertion that the taxation effect of inflationary price developments causes a loss of capital in industry which will gravely affect the well-being of the country. As long as the export factor in the national income is not significant, this dissipation of capital, seen from the national viewpoint, does not take place just because certain products are sold at a lower price than would be the case if depreciation

charged in the price were based on replacement values; but these cheaper sales have a retarding effect on the inflationary spiral. The capital remains within the country in the form of savings, etc., and is available for new capital investments.

Apart from these two thoughts which make Sir Geoffrey's conclusions partially inapplicable to this continent, he neglects to consider the main axiom, that the aim of taxation must be the coverage of government expenditure. If, therefore, taxation were taken off from what Sir Geoffrey considers fictitious profits, the government would have to seek its required revenue either from higher rates or from other taxation sources. As direct taxes should not be considered an expense in the calculation of prices, such a shift in the source or basis of direct taxation would not have a direct effect on prices nor on the national income.

In an economy free of controls management should decide in periods of high prices to refrain from the acquisition of extensive capital assets. It should also avoid increased purchasing as this leads to further price increases. Such policies would lead consequently to a retraction of the inflated price and business volume and, at least partially, remedy the difficulties. It has always been sound business policy to sell at the highest possible price and to buy at the lowest. Unless our economic system has become overloaded with high-level planning, the situation should find its natural equilibrium in the old game of demand and supply.

There are indications that we have reached on this continent the peak of the inflationary curve and it may easily be that those who worry over insufficient depreciation charges may soon start to worry over insufficient earnings to cover depreciation of fixed assets acquired in periods of highest prices. Sir Geoffrey

Heyworth complains about price control and taxation in an inflationary period.

2. United States

In his aforementioned article, "Effect of Inflation on Capital and Profits", Ralph C. Jones goes one step further and tries to prove that not only income is overstated, but that capital is being taxed and paid out in dividends. By his illustrations he tries to prove that the nine big steel companies in the United States have not earned dividends in any year since 1941. He claims that his statements are not characteristic of the steel industry alone but of all industries.

There is no doubt that Ralph Coughenour Jones' calculations and computations in his quoted article lead to interesting considerations. But we must not overlook the fact that he arbitrarily uses the index of consumers' prices of the United States Bureau of Labour Statistics as his measuring stick; consumers' prices, however, quite clearly have not followed the same development as, for instance, the prices of building material or machinery which are more significant in connection with depreciation than any other index. Jones has to admit that the data required for a thorough-going analysis of the steel industry on a replacement cost basis are neither available now nor likely to be available in the foreseeable future. He furthermore stresses the fact that his is an economic analysis in which technical considerations are of secondary importance. His methods are not offered or proposed as a solution to the problem of corporate record-keeping and financial reporting during periods of inflation and deflation. He has to assume that all non-monetary assets on the balance sheets of December 31, 1940 were expressed in dollars equivalent to the 1935-39 average. Although he tries to minimize the inherent misconception, he cannot entirely deny it.

It is surprising that Mr. Jones fails to realize that his example of the bondholder is an invitation to criticism of his whole concept which could explode the basis of his considerations. If the unfortunate bondholder would follow Mr. Jones' deliberations, he should ask the government to refund to him all the income tax which has been levied on his bond interests, as in Mr. Jones' opinion the poor bondholder did not receive any profit (interest) at all. He received only a partial repayment of his capital investment which in the end will not be fully returned to him, measured in terms of purchasing power. Interest plus capital repayment recalculated with, for instance, consumers' index figures will fall short of the economic value of the bondholder's original investment.

This reminds us of an economist's contention that there can be no profit until the original investment has been fully repaid. Doubtless this opinion has its full merits, but nevertheless it has not been adopted and would be impracticable for taxation, reporting and many other important purposes.

Invocation of LIFO Principle

One of the earliest articles on the problem was written by George O. May in the *Journal of Accountancy*,¹ in which he suggests the application of the LIFO principle to fixed asset depreciation accounting. He states that the straight line method of depreciation is of comparatively recent vintage and should not be considered a fundamental accounting concept.

His article and many others on the subject have been assembled in condensed abstract form by the Controllership Foundation, Inc. in a very instructive booklet, issued under the title "Depreciation

Policy When Price Levels Change", in November 1948. Anybody wishing to familiarize himself with this problem will find it worthwhile to read this source-book of published opinions and information on the subject.

Professor Leland C. Whetten of the University of Georgia, in another article on depreciation policies in a period of rising prices, emphasizes that "the political enemies of our economic system use these inflated profits to stir up prejudices among the uninformed against private ownership of property". He suggests debiting "net income" for the approximate decline in the value of the dollar, when prices are on the incline, and crediting the amount to an account "Estimated profit or loss from fixed asset fluctuation". This charge is deducted from net profit *after* income taxes. He accepts evidently the taxation of the fictitious inflationary profit portion as inevitable, and quotes the following statement: "Inflation is in fact a form of taxation, a levy on capital instead of a larger tax on income." He explains that his suggested fluctuation account "represents the actual retention of a certain number of sales dollars in the business which might otherwise take leave *via* dividend declaration or some other avenue".

As the fluctuation of the dollar value cannot be accurately estimated in its effect on the profit and loss statement of an enterprise, it appears preferable to us to desist from insinuating that the charge to the income account for insufficient depreciation has been determined fairly accurately. It is advisable to admit that any ear-marked portion of the profits retained in the business for replacement purposes is largely an arbitrary guess which could be correctly determined only by people with prophetic power able to foresee the price level at the time when each particular part of the plant and equipment will need replacement.

¹Vol. 84, December 1947, pp. 453-56.

Professional Bodies

This conclusion has been reached independently by the two most important bodies representing the accounting profession in England and the United States.

Recommendations on accounting principles issued by the Institute of Chartered Accountants in England and Wales under the date of January 14, 1949 bear the title: "Rising Price Levels in Relation to Accounts". As might be expected, the recommendation defines the problem and the proposed solutions very clearly. The recommendations definitely refute the attempted departure from historic costs as basis of depreciation charges to profit and loss account. A condensed description of the issue follows as an appendix to this article.

Conclusions

The following recommendations have been made in amplification of previously issued recommendations on depreciation of fixed assets and valuation of stock-in-trade:

(1) Any amount set aside to finance replacements (whether of fixed or current assets) at enhanced costs should not be treated as a provision which must be made before profit for the year can be ascertained, but as a transfer to reserve. If such a transfer to reserve is shown in the profit and loss account as a deduction in arriving at the balance for the year, that balance should be described appropriately.

(2) In order to emphasize that as a matter of prudence the amount set aside is, for the time being, regarded by the directors as not available for distribution, it should normally be treated as a specific capital reserve for increased cost of replacement of assets.

(3) For balance sheet purposes fixed assets should not, in general, be written-up on the basis of estimated replacement costs, especially in the absence of a measure of stability in the price level.

In this matter the English Institute is in agreement with the Committee on Accounting Procedure of the American Institute of Accountants, which in a letter² to the members of the American Institute reaffirmed its stand taken in the Accounting Research Bulletin No. 33 that no basic change in the accounting treatment of depreciation of plant and equipment is practicable or desirable under present conditions to meet the problem created by the decline in the purchasing power of the dollar. Only four members of the Committee dissented, claiming that inflation has proceeded to a point where original dollar costs have already lost their practical significance and that, where depreciation is an important element of cost, the advantages which would result from a basic change in accounting treatment outweigh the possible disadvantages which have been advanced against it. There is no indication of the procedure which the dissenting members would recommend in the place of depreciation based on historic costs.

U.S. Practice

The practice in the United States has largely followed the recommendations contained in Accounting Research Bulletin No. 33. The interesting study "Accounting Trends in Corporate Reports", (an accounting survey, published by the American Institute of Accountants, of 525 corporate reports for fiscal years ending between July 1947 and June 1948), shows that only 17 corporations made increased depreciation charges prior to "net income". Only 11 auditors' reports stated that their clients had deviated from generally accepted accounting principles which gives some indication of the extent to which Bulletin No. 33 was followed in the tabulated 525 reports. The pertinent portions of the 11 certificates

²The Journal of Accountancy, November 1948.

are reproduced in the booklet. Increased depreciation charges were considered in one case a change in depreciation policy in terms of consistency (Chrysler). In one case a corporation decided to rescind the practice of setting up a reserve for increased replacement costs in view of the controversy as to its propriety from an accounting point of view.

One more voice against replacement depreciation has been sounded in a very interesting article "Depreciation Policies of Canadian Railways",³ from which one paragraph is quoted:

Depreciation charges should be for assets currently being used and not for what may be used when the present assets are worn out. It is the task of the investor to supply the funds which are required for new assets. The purpose of depreciation reserve accounting is merely to insure that, so far as possible, the present investment will be preserved and that the user of the physical facilities will pay for the loss in values which is inevitable and which cannot be restored by current maintenance. Even if the railway position in this matter were

to be accepted, it does not follow that the general price level invariably trends upward or that new equipment will have exactly the same capacity as that which it replaces. Prices sometimes decline and new facilities commonly have longer life, bigger capacities, and lower operating and maintenance costs than the older equipment.

In deciding the issue, consideration must be given to the basic aim of financial reporting. Financial statements have to serve a variety of purposes, but all of these purposes can be achieved only if reports are computed on a comparable basis. If corporations would be at liberty to decide whether they wish to follow the accepted procedure of basing depreciation on historic costs or change to another more or less arbitrary policy, the postulate of comparability would be defeated.

Let us therefore cling in Canada to historic costs as a basis for depreciation charges, lest we come under suspicion of pretending to have superhuman powers of foresight!

APPENDIX

Abstract from Recommendations on Accounting Principles XII (The Institute of Chartered Accountants in England and Wales)

As stocks of materials are converted into goods and sold, and as fixed assets wear out or become obsolete, substantially greater amounts have to be invested in the assets which replace them than were invested in the purchase of those displaced; other working capital requirements likewise increase. In nearly all businesses the under-capitalisation will be felt sooner or later if the rise in prices is maintained.

The undercapitalization can be corrected

either by obtaining new capital from outside sources or by retaining in the business moneys which would otherwise be free for distribution; or by a combination of these methods.

Opinions differ as to whether capital impaired in the ordinary course of trading is to be defined for this purpose as

(a) the money contributed by the proprietors, including profits left by them in the business for financing it, or

³The Canadian Chartered Accountant, February, 1949.

(b) the power of that sum of money to purchase a particular volume of goods or equipment.

This proposition is at variance with the accounting practice hitherto generally followed of treating as charges to revenue the actual monetary cost of the stocks consumed or sold and depreciation provisions representing the appropriate proportion of the amounts carried in the books for fixed assets (usually their historical cost).

The defenders of the view hitherto accepted point out

that it would be illogical, in ascertaining profit, to treat as a necessary charge the cost of maintaining the purchasing power of money provided by the issue of fixed preference or loan capital, whilst ignoring the corresponding diminution in the obligation, expressed in terms of purchasing power, to the holders of that capital. They emphasize that if the new conception were adopted the holders of preference shares might be deprived of dividends without acquiring any capital benefit. Moreover, they point out, as regards goods consumed or sold, that those who desire the change have not yet been able to devise a satisfactory method, suitable for general use, of ap-

plying the principle advocated and, as regards fixed assets, that, owing to improved processes of manufacture, plant which becomes worn out or obsolete is not invariably replaced. Further, they claim that not only is the suggested change wrong in principle, but also that it strikes at the root of sound and objective accounting because of the practical difficulties of assessing the amounts which would be treated as charges to revenue if the new conception were adopted.

... relative stability of prices on a new level has not yet been attained ...

Owing to the inherent difficulty of determining in advance the prices which may have to be paid in the future for the replacement of assets, it is impracticable to forecast with any precision the additional reserves which will be required. This fact alone is likely to necessitate modification of any plan whereby the actual sums required to effect replacements are provided by instalments over a period of years, either by way of supplementing depreciation charges or by setting up in lieu of depreciation a provision for renewals based on estimated replacement costs. Moreover, the gap between historical and replacement costs might be too big to be bridged in these ways.

1948-49 CANADA YEAR BOOK

The Dominion Bureau of Statistics announces that the 1948-49 edition of the Canada Year Book can now be obtained from the King's Printer, Ottawa, at the price of \$2 a copy, cloth bound. Paper-bound copies can be purchased for \$1 by teachers, university students and ministers of religion on application to the Dominion Statistician, Dominion Bureau of Statistics, Ottawa.

Professional Notes

BRITISH COLUMBIA

Ismay, Boiston, Dunn & Co., Chartered Accountants, Pemberton Bldg., Victoria, B.C. announce the admission to partnership of Mr. Harold G. Craven, C.A. and Mr. Reginald John Nation, C.A. The firm will continue to practise under its present name.

* * *

Mr. Robert Bell, C.A. announces that Mr. Ian Hunter Bell, C.A., has joined him as a partner and that the practice will in future be conducted under the firm name of Robert Bell & Co. at 744 West Hastings St., Vancouver, B.C.

* * *

Mr. W. B. Monteith, C.A. announces the removal of his office to Suite 6, Richardson Bldg., 543 Bastion St., Victoria, B.C.

* * *

Mr. Robert D. Young, C.A. announces the opening of an office for the practice of his profession at 1019 Vancouver Block, 736 Granville St., Vancouver, B.C.

MANITOBA

Schacter, Gilman & Co., Chartered Accountants, announce the admission to partnership of Mr. David Halpern, C.A. Their practice will continue under the firm name of Schacter, Gilman, Halpern & Co., with offices in the Trans-Canada Bldg., 325 Main St., Winnipeg, Man.

NEW BRUNSWICK

STUDENT CONFERENCE AT MONOTON

The New Brunswick Institute of Chartered Accountants Students' Society, Moncton branch, held an outstandingly successful student conference on Friday and Saturday, May 13 and 14, which was attended by about 95 students and 30 members. Many guests were also present for some of the social functions.

Speakers were Mr. Ivor Laws who spoke on depreciation, Mr. T. J. Hammett who spoke on inventory valuation and Mr. A. E. Mowatt who spoke on cost accounting. Mr. Victor Johnson was chairman of this session.

Following the dinner on Friday evening, presided over by Mr. Alfred F. Gosling, Mr. Clem L. King, secretary of the Dominion Association of Chartered Accountants, who was introduced by Mr. J. A. Marven, spoke on the history and development of accounting to meet the demands of commerce. The dinner was followed by a dance.

At a symposium on Saturday morning, Victor Johnson presented the case for the primary student, Joe Harper for the intermediate student and Arnold Sarty for the senior student group. The position of the employer was ably outlined by Lt.-Col. G. W. Hudson, Mr. Clem L. King followed with a talk on examinations. Mr. G. A. Oulton, secretary of the Institute, presided at this session.

Following luncheon, Mr. W. A. Morrell, F.C.A., vice-president of the Dominion Association, spoke on the development of the profession in the Maritimes. Walter W. B. Dick introduced Mr. Morrell and Richard Rice proposed the vote of thanks. Mr. Arnold Sarty presided.

On Saturday afternoon Mrs. Irma MacPherson discussed the auditor's certificate, Mr. Charles W. Campbell spoke on the Income Tax Act (1949) and Mr. David Reevey spoke on professional ethics. Noble Coleman, a student, presided.

ONTARIO

CHARTERED ACCOUNTANTS STUDENTS' ASSOCIATION ANNUAL GENERAL MEETING

The Chartered Accountants Students' Association of Ontario held their annual general meeting in the theatre of the Royal Ontario Museum on Wednesday, May 18th, 1949.

After the business of the meeting was concluded, Mr. J. Grant Glassco, F.C.A., president of the Institute of Chartered Accountants of Ontario, presented a short summary of the history of public accounting in Canada, England and the U.S.A., and also discussed a bill recently proposed in the On-

tario Legislature to incorporate a new body of accountants known as the A.P.A.

The results of the elections for the coming year were announced. They were as follows: president—D. M. McClelland; vice-president—R. J. Kane, C.A.; secretary—A.A. McMichael; treasurer—R. A. Johnston; other members of council—J. W. Bennett, G. R. Butler, J. S. McFadden, D. G. Scott, C.A., V. J. Thompson and J. K. Walker.

* * *

**THE CHARTERED ACCOUNTANTS CLUB
OF OTTAWA**

A highly successful spring golf tournament and annual meeting of the Chartered Accountants' Club of Ottawa was held at the Rivermead Golf Club on June 14, 1949. Mr. James Ross presided. The winners in the golf tournament were: T. G. Wilson, A. S. Merrikin, E. D. Martin, Low Gross; J. B. Kearney, Second Low Gross; J. R. Lewis, Low Net; D. McLean, Second Low Net; G. P. Rice, High Gross; B. W. Calver, Sealed Holes.

Those elected to the executive for the coming year were: H. T. Aitken, A. C. Brittain, N. W. Cleary, J. K. Davey, C. F. Elderkin, C. G. Gale, J. G. Lumsden, and E. F. O'Brien.

Students' Branch

The Students' Branch of the Chartered Accountants Club of Ottawa, which was formed in December, 1948, held its first annual meeting on May 27 and elected the following executive for the ensuing fiscal year: K. T. N. Lapp, C.A., past president; G. M. Welch, president; S. G. Payne, vice-president; C. Ottom, secretary; K. Hurd, treasurer; A. G. Holley, D. A. S. Kirby, R. P. Morris, and M. J. Stotesbury, members. Mr. K. T. N. Lapp gave a brief outline of the history of the branch and at the conclusion of the meeting a social evening was held.

QUEBEC

Messrs. Oscar Blain, C.A., and Georges Lafontaine, C.A., announce the removal of their offices to 477 St. Francis Xavier St., Montreal, Que.

**QUEBEC STUDENTS' SOCIETY ANNUAL
MEETING**

The annual meeting of the Chartered Accountants Students' Society of Quebec was held in the offices of The Institute of Chartered Accountants of Quebec in Montreal on May 27, 1949, at which time the retiring president, Roland R. Pouliot, C.A., reviewed the activities of the past year and revealed that the membership of the Society had now increased to over 1,500, largely because of the strong support of chartered accountant and university graduate members.

Outstanding events sponsored by the Students' Society during the year included a forum on the new Income Tax Act addressed by Mr. H. H. Stikeman, B.A., B.C.L.; a series of dinner meetings on practical accounting and allied subjects; a comprehensive series of review lectures for the benefit of examination candidates, conducted in both English and French; and on the social side, the annual field day, annual dance and a spring smoker. Also worthy of mention is the action of the Executive Committee in arranging for 30 of the Society's chartered accountant members to attend a free course on accounting for executives at the International Business Machines Company school at Endicott, N.Y. at the end of May. In order to increase good fellowship among the young professional and business men of the community, members of the Junior Bar Association, Chambre de Commerce des Jeunes and the Young Men's Section of the Montreal Board of Trade, were invited to several of the above functions. Executive officers elected for the 1949-50 year were: president, R. C. Berry, C.A.; vice-presidents, W. P. Gould, C.A., Marcel Caron, C.A.; treasurer, J. P. Latendresse; secretary, R. G. Buckingham. Committee members will be: Wm. H. Boyce, R. G. Bremner, W. B. Buckley, C.A., Wm. Chadwick, D. H. Davidson, Richard Davine, Louis Desmarais, Marcel Hurtubise, C.A., Peter Leggat, Jean Parisien.

* * *

Mr. Bernard Goodman, C.A., of Goodman & Goodman, Chartered Accountants, Montreal, has been elected an international associate of the American Institute of Accountants.

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

Report of the Committee on Education and Examinations

The Committee on Education and Examinations met on Monday and Tuesday, May 2nd and 3rd. Representatives were present from each of the nine institutes. It met to discuss the training of students for the profession with particular reference

to the content and scope of the courses of instruction, uniform examinations, the reporting of examination results as well as many other matters pertaining to examinations and the selection and training of students.

Report of the Committee on Accounting and Auditing Research

The Committee on Accounting and Auditing Research met on Wednesday and Thursday, May 18th and 19th. Among the topics discussed by the Committee were accounting for bad debt losses, the valuation of inventories, the re-

vision of the manual on accounting terminology with a detailed discussion of the definition of the terms "surplus" and "depreciation", in addition to a number of other projects.

Newfoundland Institute

The Institute of Chartered Accountants of Newfoundland was incorporated on March 31, 1949. The chartered members of the Institute are:

Herbert R. Brookes, Arthur C. L. Hudson, Robert Leith, Herbert A. Pike, and Alec H. Ritcey, members of The Institute of Chartered Accountants of Nova Scotia; George W. D. Allen and George C. Row, members of The New Brunswick Institute of Chartered Accountants; Howard J. McDougall, a member of The Institute of Chartered Accountants of Manitoba; James G. Wyllie, a member of The Institute of Chartered Accountants of Quebec; Charles D. Drysdale and John Hyslop, members of The Institute of Accountants and Actuaries in Glasgow; Reginald B. Moyse, a member of The

Institute of Chartered Accountants in England and Wales; Francis G. Huck, a member of The Society of Incorporated Accountants and Auditors (England); Archdale S. Lewis, a member of The Association of Certified and Corporate Accountants (England), (all of the foregoing being presently resident in Newfoundland); and James C. Thompson, a member of The Institute of Chartered Accountants of Alberta, and Harvey E. Crowell, a member of The Institute of Chartered Accountants of Nova Scotia.

The Newfoundland Institute has declared its intention of seeking affiliation with the other nine provincial institutes as a recognized society under the by-laws of the D.A.C.A.

OBITUARIES

Arthur Harper Edwards

The Institute of Chartered Accountants of British Columbia announces with deep regret the passing of Arthur Harper Edwards in his 72nd year.

The late Mr. Edwards was born in Toronto where he received his education and professional training. He was admitted to the Institute of Chartered Accountants of Ontario in the year 1902.

He was active in the organization of the Institute of Chartered Accountants of Alberta in the year 1910 and was that Institute's first President.

Upon moving to Vancouver, he was admitted a member of the Institute of Chartered Accountants of British Columbia in the year 1911 and elected a fellow in the year 1913. He served on the Council of the British Columbia Institute for the years 1912 to 1916 when he took particular interest in students' education and was President in the year 1915. His passing is mourned by a wide circle of friends.

To his widow and daughter the members of the Institute extend their sincere sympathy.

Geoffrey Teignmouth Clarkson

The Institute of Chartered Accountants of Ontario announces with deep regret the death of Geoffrey Teignmouth Clarkson in his 71st year. Mr. Clarkson was a fellow of the Ontario Institute and senior partner of the firms of Clarkson, Gordon & Co., Chartered Accountants, and E. R. C. Clarkson & Sons, Trustees, Receivers and Liquidators.

The son of Mr. E. R. C. Clarkson, a founder of both the Ontario Institute and the Dominion Association, Mr. G. T. Clarkson passed the final examinations of the newly formed Dominion Association in 1902. In 1906 and again in 1908 he was elected secretary of the Dominion Association and when the Dominion Association became federated with the Provincial Institutes in 1910, Mr. Clarkson became a member of the Ontario Institute. Subsequently he was a member of the Council of the Ontario Institute in 1910, 1918 and 1919.

In 1913 Mr. G. T. Clarkson and his father joined with Colonel H. D. L. Gordon and the late Mr. R. J. Dilworth to form the accounting firm of Clarkson, Gordon & Dilworth. While still continuing as auditor of chartered banks and public institutions Mr. Clarkson increasingly devoted his time to the management of companies in receivership, including in recent years Abitibi Pulp & Paper Company Limited and the Barcelona Traction Light & Power Company Limited. He became a leader among his fellow accountants in changing the outlook of the profession from one of routine checking of transactions in the books of account to one in which an independent viewpoint was brought to bear on financial statements in order to determine whether they did disclose the true financial position of the company.

The late Mr. Clarkson was active in many clubs and associations but was particularly interested in the field of secondary education, being President of Havergal College and a Governor of Upper Canada College.

The members of the Institute offer their sincere sympathy to his widow, children, brothers and sisters who survive him and particularly to his son, Mr. G. P. Clarkson, a member of the Ontario Institute and a partner in the firm of Clarkson, Gordon & Co.

John William Harper

The Institute of Chartered Accountants of Ontario announces with deep regret the death of John William Harper in his 51st year.

Born in Wallaceburg, Mr. Harper came to Toronto 30 years ago. He was admitted to the Ontario Institute in 1929 and for a number of years was in practice for himself. Later he became a partner in the firm of Cossar, Harper & Company. He was also secretary-treasurer for Lilllico Limited, drug distributors.

To his widow, children and sister, the members of the Institute offer their sincere sympathy in their bereavement.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

SOME TIME AGO we published a problem on the calculation of idle capacity loss and factory service price and efficiency variances (February and March issues). The next question of course is where these items should appear in the income statement, and we would welcome opinions from readers.

For our own part we have been rather partial to actual cost as the basis for measuring income, while admitting that there may be some doubt as to what "actual cost" in fact is. At any rate in the past we have been in the habit of thinking of price and efficiency variances as being merely adjustments to standard costs to bring them back to actual costs. Accordingly we thought it proper to present all the variances along with the standard cost of goods manufactured as factors in the calculation of gross trading margin.

The variances for a period do not apply to the value of inventories at the *beginning* of the period. If it is to be argued they should enter into the cost of goods sold, then they do so through the medium of cost of goods manufactured. This creates two likely choices for the accountant: either the variances may be applied in their entirety to cost of goods sold for the period, or they may be apportioned between cost of goods sold and *closing* inventory values. We suggest the latter is theoretically the correct procedure but no doubt there are many accountants who would consider it imprac-

tical to adjust closing inventories for a portion of variances, particularly if the variances were not significantly large. Besides, if some part of the variances is to be deferred, there is the ticklish problem of deciding what are the respective portions which belong to each of raw materials, work in process, and finished goods inventories.

The theory supporting the apportionment of variances between cost of goods sold and closing inventories appears to be beyond challenge in at least one case. This is where it has become clear that standard costs are no longer current standards. Apart from this possibility, there is also another argument which, if we interpret it correctly, would have only the *price* variances as part of the cost of goods manufactured. The efficiency variances would be presented after the calculation of gross trading margin as administrative expenses (i.e., costs of management). This is evidently an attempt to separate the things which management cannot control (prices) from the things which presumably it can control (efficiency). To make the efficiency variances an element in the measurement of gross trading margin is to suggest that they, in common with the price variances, should be apportioned between cost of goods sold and the value of closing inventories; and efficiency, so the argument runs, belongs entirely to the period under review and should not be allowed

either to subsidize or prejudice the future (as would certainly be the case if efficiency variances were permitted to affect the value of closing inventories). The safe thing to do then is to keep them out of the calculation of gross trading margin altogether.

The logical conclusion of this approach is that each variance should be examined on its own merits to determine how it ought to be treated in the income statement. Even a price variance can be the result of inefficiency; it may be traced to a failure to purchase from the cheapest source or to failure to take advantage of discounts.

This still leaves us with the problem of placing loss from idle capacity. It is generally conceded that this item has a significance of its own and that it must be measured separately and in addition to the price and efficiency variances. The point is whether loss from idle capacity is one of those things that is beyond the control of management. If it is, then it

would appear from the above argument that it is a production cost, should enter into the calculation of gross trading margin, and (at least if significant) should be apportioned between cost of goods sold and closing inventories. On the other hand loss from idle capacity may often be traced to managerial decisions; management may refuse to lower price to increase output, or may even increase price as its idea of how to offset a loss, and in so doing reduce output. Further, management may have failed to explore markets that would take the product. If we use the criterion of whether or not an item is controllable to determine its position in the income statement, we are obliged to regard loss from idle capacity under any of these circumstances as an administration expense.

The reader who is interested in pursuing the matter is referred to an article entitled "Mismatching of Costs and Revenues" by John G. Blocker in the January 1949 issue of *The Accounting Review*.

CORRESPONDENCE

Kingston, Ontario.

Sir: I have read with interest the letter of William H. Gray, C.A. printed on page 234 of your May issue.

I wish to take issue with the following statement made in his letter:

"In the normal use of the term 'Deferred charge' there is no necessary implication that such a charge constitutes an asset. It is meant to indicate simply the postponement of a charge or expense which has been incurred so as to give effect to such expense in future income statements."

I submit that inclusion of the item "Deferred charge" under the general balance-sheet heading "Assets" is not an implication but an assertion that it is an asset. Likewise, I contend that any "postponement of a charge or expense which has been incurred so as to give effect to such expense in fu-

ture income periods" is, by definition, an asset.

In my view, bond discount is something entirely different in kind. In the example, the company has borrowed \$2,940,000. In 1967, it will have to pay back an amount of \$3,000,000. The difference of \$60,000 is not a charge or an expense as nothing has been laid out or expended.

The future value of the liability is \$3,000,000 and the present value is smaller by \$60,000. As a matter of informative presentation or disclosure of information, it seems necessary to treat the discount as a liability valuation account and to show its relationship to the liability which it describes. A balance sheet of a going-concern is a historical document and should not be constructed in terms of future values rather than present values.

W. G. LEONARD, C.A.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect of course the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, November 1948

Accounting I, Question 6(15 marks)

The Board of Directors of a manufacturing company wishes to install a satisfactory payroll system for their factory employees, who number about 300. These workers are paid at an hourly rate, and the payroll is to be met every Tuesday for the week ending the preceding Friday. The factory operates two eight-hour shifts a day. The plant is divided into eight departments, each under the supervision of a foreman. Due to the inaccessibility of banking facilities, the payroll must be met in cash.

Required:

Describe a satisfactory system and explain its operations.

Amplify by sketching the records which would be used to determine the amount due a hypothetical employee in respect of his work for any one week and the payment thereof.

SOLUTION

1. Each employee is hired through the personnel office and is given a number. The personnel office then informs the paymaster and the accounting department of the employee's number, the department to which he has been assigned, his rate of pay, and the date of commencement.

A rate card may be prepared for each employee showing the date and authorization for his rate of pay and having on the back a place for the employee to signify agreement with any special deductions for insurance, savings, etc.

2. Employee punches time clock on his own card when he comes and when he leaves work. No one will be allowed to punch for any one else.

John Doe's card might appear as follows:

Name: John Doe, #678, Department #7	Card No. 6789
Week of: 4th June to 10th June	
In	Out
F	
S	
S	
M	
T	
W	
T	
Total Time	
Regular hours	@ Amount \$
Overtime	@ Amount \$
Wages for week	\$
O.K.'d	
Signature of Foreman	

Note: In addition to the Foreman O.K.-ing the time card, it is often the practice to have the Foreman prepare a distribution of labor report showing the jobs done by the employees in his department for the week.

3. The time cards are summarized on the payroll summary for each week by the paymaster. The payroll summary will then be completed as to deductions by the accounting department from their records of the employee.

PAYROLL SUMMARY FOR WEEK ENDING 10th JUNE, 1948

No.	Name	Hours Worked		Rate		Wages for Work			Total
		Regular	Overtime	Regular	Overtime	Regular	Overtime		
678	John Doe								
Deductions									
		Income Tax	Unemployment Insurance, etc.			Total		Net Wages	

4. Clerk #1 in the Accounting Department calculates the cash required.
5. Cheque is drawn for the exact amount of the payroll and cashed. Bills and change secured on basis of Summary prepared by Clerk #1.
6. Clerk #2 in Accounting Department inserts correct amount of cash in pay envelopes and seals envelopes.
7. Clerk #3 in Accounting Department issues pay envelopes, in presence of paymaster, to employees, who sign for the receipt thereof.
8. The Accounting Department will also keep a record of each employee's earnings, drawn up as follows:

Employee	Phone No.			
Address				
Married	Dependents			
Week Ending	Gross Wages	Income Tax	Unemployment Insurance, etc.	Net Wages
—				
—				
—				

PROBLEM 2

Final Examination, November 1948

Accounting II, Question 4 (20 marks)

The KLOP Company maintains its records on the process cost basis. The company is engaged in the manufacturing of a product which must go through three processes, cleaning, milling and finishing. Two raw materials go into the manufacture of this product: M the basic material and N, a material used in finishing. The basic material must be cleaned before entering the milling process.

Raw materials on hand as at 1st January 1948 were:

M—360,000 lbs. @ \$.08	\$28,800
N— 20,000 lbs. @ .16	3,200
	<hr/>
	\$32,000

The materials in process as at 1st January 1948, according to the records, were as follows:

		Percentage Completed	Cost
Cleaning—Material	200,000 lbs.	100%	\$14,400
Labor		40	6,400
Indirect factory costs		40	3,200
			<hr/> \$24,000
Milling—Material	160,000 lbs.	100%	\$32,000
Labor		65	5,000
Indirect factory costs		65	6,600
			<hr/> \$43,600
Finishing—Material	240,000 lbs.	100%	\$79,000
Labor		50	11,500
Indirect factory costs		50	5,800
			<hr/> \$96,300

The stores records, which were maintained on a FIFO basis, provide the following information:

Purchases	Quantity	Material	Cost per Pound
1948 January 5	100,000 lbs.	M	\$.08
7	10,000 "	N	.15
13	120,000 "	M	.09
17	200,000 "	M	.08
21	24,000 "	N	.17
22	400,000 "	M	.07
29	10,000 "	N	.18
Purchase returns			
January 19	36,000 "	M	.08
Stores issues			
Date	Material	Amount	
1948 January 3	N	8,000 lbs.	
5	M	200,000 "	
10	N	10,000 "	
12	M	200,000 "	
17	N	10,000 "	
20	M	260,000 "	
24	M	180,000 "	
29	N	14,000 "	

Units completed during January 1948 and transferred were as follows:

From cleaning to milling	840,000 lbs.
From milling to finishing	800,000 "
From finishing to finished goods	880,000 "

Wages for January 1948 were as follows:

Cleaning	\$70,000
Milling	42,000
Finishing	98,000

Indirect factory costs for January 1948 were as follows:

Cleaning	\$36,900
Milling	57,600
Finishing	45,900

The goods in process and stage of completion at the end of the month were as follows:

Department	Quantity in Units	Percentage Completed		
		Materials	Labor	Indirect Factory Costs
Cleaning	180,000	100%	60%	60%
Milling	188,000	100%	60%	50%
Finishing	200,000	90%	40%	60%

Required:

A statement showing the cost of goods manufactured during January 1948 and the value of goods in process at 31 January 1948. (Carry all computations to the nearest dollar.)

SOLUTION
INVENTORY ON FIFO BASIS
Material "M"

1948	Quantity	IN		OUT		Amount
		Unit Cost	Amount	Quantity	Unit Cost	
January 1	360,000	\$.08		200,000	\$.08	\$16,000
5	100,000	.08		200,000	.08	16,000
12				60,000	.08	4,800
13	120,000	.09		120,000	.09	10,800
17	200,000	.08		80,000	.08	6,400
20				36,000	.08	2,880
22	400,000	.07		84,000	.08	6,720
24				96,000	.07	6,720
						\$70,320
						2,880
						<u><u>\$67,440</u></u>

Material "N"						
January	Quantity	Unit Cost	Amount	Quantity	Unit Cost	Amount
1	20,000	\$.16		8,000	\$.16	\$ 1,280
3						
7	10,000	.15		10,000	.16	1,600
10				2,000	.16	
17				8,000	.15	1,520
21	24,000	.17		2,000	.15	300
29	10,000	.18		12,000	.17	2,040
						<u><u>\$ 6,740</u></u>

KLOP COMPANY
COST OF GOODS MANUFACTURED DURING JANUARY 1948

				Indirect Factory Costs	Goods in Process 31 January 1948
		Material			
CLEANING		Units	Amount	Labour	
In Process — Jan. 1, 1948	200,000	\$ 14,400	\$ 6,400	\$ 3,200	
Into Process	840,000	67,440	70,000	36,900	
	<hr/>	<hr/>	<hr/>	<hr/>	
	1,040,000	81,840	76,400	40,100	
Shrinkage	20,000				
	<hr/>	<hr/>	<hr/>	<hr/>	
	1,020,000				
In Process — Jan. 31, 1948	180,000	14,443	8,704	4,568	27,715
Transferred to Milling	840,000	\$ 67,397	\$ 67,696	\$ 35,532	
Equivalent completed units	1,020,000		948,000	948,000	
	<hr/>	<hr/>	<hr/>	<hr/>	
MILLING					
In Process Jan. 1, 1948	160,000	\$ 32,000	\$ 5,000	\$ 6,600	
Into Process	840,000	170,625	42,000	57,600	
	<hr/>	<hr/>	<hr/>	<hr/>	
	1,000,000	202,625	47,000	64,200	
Shrinkage	12,000				
	<hr/>	<hr/>	<hr/>	<hr/>	
	988,000				
In Process Jan. 31, 1948	188,000	38,556	5,808	6,750	51,114
Transferred to Finishing	800,000	\$164,069	\$ 41,192	\$ 57,450	
Equivalent completed units	988,000		912,800	894,000	
	<hr/>	<hr/>	<hr/>	<hr/>	
FINISHING					
In Process Jan. 31, 1948	240,000	79,000	11,500	5,800	
Into Process	800,000	262,711	98,000	45,900	
Material	42,000	6,740			
	<hr/>	<hr/>	<hr/>	<hr/>	
	1,082,000	348,451	109,500	51,700	
Shrinkage	22,000				
	<hr/>	<hr/>	<hr/>	<hr/>	
	1,060,000				
In Process Jan. 31, 1948	180,000	59,171	9,125	6,204	74,500
Transferred to finished goods	880,000	\$289,280	\$100,375	45,496	
Equivalent completed units	1,060,000		960,000	100,000	
Cost of goods manufactured	880,000	units costing		\$435,151	
	<hr/>	<hr/>	<hr/>	<hr/>	
Goods in process 31st Jan. 1948					\$153,329
	<hr/>	<hr/>	<hr/>	<hr/>	

Notes: (a) Alternatively the Statement of Cost of Goods Manufactured might be presented along the following lines:

Goods in Process Jan. 1		\$163,900
Raw material used:		
Inventory Jan. 1.	\$32,000	
Purchases	\$ 70,180	
Less Returns	2,880	67,300
		99,300
Less Inventory Jan. 31.	25,120	74,180
Direct Labour		210,000
Indirect Factory costs		140,400
Total Manufacturing Cost		\$588,480
Less Inventory of Goods in Process		153,329
Cost of Goods Manufactured		\$435,151

(b) If the shrinkage is costed separately some indication should be given that normal shrinkage is to be regarded as a cost of production and abnormal shrinkage is an expense to be carried to profit and loss.

Editor's Note: In the above solution work in process inventories were valued by the average cost method, and raw material inventories (as required by the problem) by the first-in first-out method. To assist students attempting this problem, the editor has prepared the following schedule in support of the values assigned the work in process inventories above.

KLOP COMPANY

CALCULATION OF WORK IN PROCESS INVENTORIES, JANUARY 31, 1948

1. Cleaning Process

(1) Units produced:	Materials	Labor	Factory Service
Units completed in January	840,000 lbs.	840,000 lbs.	840,000 lbs.
Equivalent units in closing inventory (180,000 lbs.)	180,000	108,000	108,000
	1,020,000 lbs.	948,000 lbs.	948,000 lbs.
(2) Cost of production	\$81,840	\$76,400	\$40,100
(3) Average unit cost (2) + (1)	.08023	.08059	.0423
(4) Equivalent units in inventory Jan. 31	180,000 lbs.	108,000 lbs.	108,000 lbs.
(5) Work in process Jan. 31 (4) x (3)	\$14,443	\$8,704	\$4,568

2. Milling process

(1) Units produced	Materials	Labor	Factory Service
Units completed in Jan.	800,000 lbs.	800,000 lbs.	800,000 lbs.
Equivalent units in closing inventory (188,000 lbs.)	188,000	112,800	94,000
	988,000 lbs.	912,800 lbs.	894,000 lbs.

(2) Cost of production	\$202,625	\$47,000	\$64,200
(3) Average unit cost (2) \div (1)	.2051	.05148	.0718
(4) Equivalent units in inventory Jan. 31	188,000 lbs.	112,800 lbs.	94,000 lbs.
(5) Work in process Jan. 31 (4) \times (3)	\$38,556	\$5,808	\$6,750

3. Finishing process

(1) Units produced

Units completed January	880,000 lbs.	880,000 lbs.	880,000 lbs.
Equivalent units in closing inventory (200,000 lbs.)	180,000	80,000	120,000
	1,060,000 lbs.	960,000 lbs.	1,000,000 lbs.
(2) Cost of production	\$348,451	\$109,500	\$ 51,700
(3) Average unit cost (2) \div (1)	.32873	.11407	.0517
(4) Equivalent units in inventory Jan. 31	180,000 lbs.	80,000 lbs.	120,000 lbs.
(5) Work in process Jan. 31 (4) \times (3)	\$59,171	\$9,125	\$6,204

PROBLEM 3

Final Examination, November 1948

Accounting II, Question 5 (20 marks)

On 15th March 1947, the T. N. Dem Co. Ltd., manufacturers of bicycles, commenced operations. Based upon an examination of the costs incurred during the first five days of operations, during which a standard production of 200 bicycles per day was set, the following standard factory costs were set up:

Department	Total	Materials	Labour	Overhead
1. Cutting and welding	\$ 3.75	\$.75	\$ 1.40	\$ 1.60
2. Machining	20.25	8.25	9.20	2.80
3. Assembling	3.00	2.20	.80
4. Inspecting	3.00	1.60	1.40
	<u>\$30.00</u>	<u>\$ 9.00</u>	<u>\$14.40</u>	<u>\$ 6.60</u>

It was also estimated that if a double shift were put into operation on any one day, the rate of overhead would be reduced by 25%, although night-shift wages would be 25% more than regular wages.

After operations had been carried on for 30 days, the following statement was prepared:

Production Statement for 30 Days of Operation Bicycles produced (200 per day for 30 days) 6,000

Factory costs:

	Recorded Costs
Cutting and welding department—	
Materials	\$ 4,800
Labor	8,640
Overhead	10,500
Machining department—	
Materials	49,200
Labor	56,400
Overhead	18,000

Assembling department—

Labor	13,200
Overhead	5,700

Inspecting department—

Labor	8,400
Overhead	9,300

\$184,140

About the middle of April, the company's salesmen reported to the management that they had found a number of the company's bicycles being sold at prices significantly lower than the company's sales price. Acting upon this information, an investigation of production and records was made, and it was found that the factory foreman and the cost accountant had run a night-shift for five nights, thus producing 1,000 bicycles which were then sold at cut prices for cash. After paying the night-shift wages, the balance of the proceeds was divided between the foreman and the cost accountant. No records in connection with the night-shift wages, materials or production were kept.

Required:

- (a) Statement of actual and standard manufacturing costs for the 30-day period.
- (b) Estimated loss resulting from the unauthorized production and sale of the 1,000 bicycles.

SOLUTION

(a) *See p. 44*

(b)

Estimated loss resulting from the theft of the 1,000 bicycles (assuming materials, though not recorded, were taken from stores):

Actual cost per records	\$184,140
Estimated actual cost	181,020
Loss	<u>3,120</u>
Add: Materials short in inventory for 1,000 bicycles on basis of actual costs for 6,000	9,000
Total estimated loss	<u><u>\$ 12,120 plus</u></u>

the difference between selling price and cost to sell of the 1,000, if they could have been sold.

—or alternate calculation—

Actual costs of 7,000 bicycles	\$211,190
Cost of 6,000	181,020
Cost of 1,000	<u>\$ 30,170</u>
Less—Wages paid direct by foreman and accountant	18,050
Estimated Loss	<u><u>\$ 12,120 plus</u></u>

the difference between selling prices and cost to sell of the 1,000 bicycles, if they could have been sold.

SOLUTION
T. N. DEM COMPANY LIMITED
STATEMENT OF STANDARD AND ACTUAL MANUFACTURING COSTS
For 30-day period

Bicycles produced	Standard cost 200 per day for 30 days	Rate	Amount	Adjustments to Standard cost re 5-days @ double-time		Cost recorded	Rate	Amount	Additional unrecorded cost re 5-days @ double-time based on actual recorded time		Estimated Total Manufacturing Costs Standard	Actual
				Rate	Amount				Rate	Amount		
Department 1:			6,000		1,000			6,000		1,000		
Materials	\$.75	\$ 4,500	\$.75	\$ 750	\$.80	\$ 4,800	\$.80	\$ 800	\$ 5,250	\$ 5,600		
Labor	1.40	8,400	1.75	1,750	1.44	8,640	1.80	1,800	10,150	10,440		
Overhead	1.60	9,600	1.20	1,200	1.75	10,500			10,400	10,500		
				.40#	400#							
Department 2:												
Materials	8.25	49,500	8.25	8,250	8.20	49,200	8.20	8,200	57,750	57,400		
Labor	9.20	55,200	11.50	11,500	9.40	56,400	11.75	11,750	66,700	68,150		
Overhead	2.80	16,800	2.10	2,100	3.00	18,000			18,200	18,000		
				.70#	700#							
Department 3:												
Labor	2.20	13,200	2.75	2,750	2.20	13,200	2.75	2,750	15,950	15,950		
Overhead	.80	4,800	.60	600	.95	5,700			5,200	5,700		
				.20#	200#							
Department 4:												
Labor	1.60	9,600	2.00	2,000	1.40	8,400	1.75	1,750	11,600	10,150		
Overhead	1.40	8,400	1.05	1,050	1.55	9,300			9,100	9,300		
				.35#	350#							
Total	\$30.00	\$180,000	\$30.30	\$30,300	\$30.69	\$184,140	\$27.05	\$ 27,050	\$210,300	\$211,190		

Estimated actual cost of 6,000 out of the 7,000 bicycles produced.
 (# denotes red)

\$181,020



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